CRUDE OIL VALUATION WORKSHOP (October 7-8, 1997)
HOUSTON

Attendees

NAME	COMPANY	PHONE NUMBER
David Simpson	Total Minatome	(713)739-3067
Ben Dillon	IPAA	(202)857-4722
Jim McCabe	City of Long Beach	(562)570-2211
Tammy Naron	Apache Corp	(713)296-6852
Tom White	Walter Oil	(713)659-1221
John Northington	U.S. DOE	(202)586-5065
Eric Ehrig	Unocal	(218)287-7846
John Munsch	DPC/Santa Fe	(713)507-5703
June Crosby	Mitchell Energy	(713)377-5521
Sara Tays	Exxon Co USA	(713)680-7730
Marie McGowan	Exxon Co USA	(713)656-5284
Richard Pepper	CNG	(504)593-7512
Wayne Pachall	Texaco	(713)752-7412
Richard McPike	Fina	(214)750-2820
Richard Maillet	State of Louisiana	(504)342-4543
Chris Jolley	Oxy USA Inc	(713)215-7237
John Clark	COPAS/Conoco	(405)767-5044
John Haley	Conoco	(281)293-1683
Becky McGee	DPC/Oryx Energy	(972)715-3198
George Staigle	State of North Dakota	(701)250-4681
Carol Harvey	Conoco	(281)293-5108
Shawna Hopkins	STRAC	(303)275-7467
Geoff Heath	AMSOC	(303)236-2056
Dave A Hubbard	MMS	(303)275-7260
Peter Christnacht	MMS	(303)275-7252
Deborah Gibbs Tschudy	MMS	(303)275-7200
Michael L. Adams	State of Louisiana	(713)630-0093
Mary Stonecipher	Amoco	(918)581-4354
Dave Ioder	Amoco	(281)366-2181
Don Sant	MMS	(303)231-3899
Randy Bolles	State of Wyoming	(307)777-7547
Jerry Huchinson	State of Wyoming	(307)777-6524
David Darouse	State of Louisiana	(972)783-0029
Jerry Schanke	API	(202)682-8116
Bob Kronebusch	MMS/PMI	(303)275-7113
Valdean Severson	State of New Mexico	(505)827-0953

Kenneth Gullett	Coastal Oil & Gas Company	(713)877-6876
Bonn Macy	MMS	(202)208-3827
Judy Rogers	Hall-Houston	(713)228-0711
Dave Deal	API	(202)682-8261
Don Lynch	Texaco	(504)595-1331
Mary Ann O'Malley	BP	(216)586-3664
David Blackmon	IPAA	(817)347-8354
Fred Hagemeyer	Marathon	(713)296-2505
Bob Teeter	Coastal	(713)877-7019
Bill Pitcher	Anadarko	(281)874-3474
John Pennell	Coastal	(713)418-4241
Kyle Harris	NYMEX	(212)299-2340
Dave Shampang	Exxon	(713)680-7898
Michael Molberg	Total Minatome	(713)739-3240
Carla Wilson	IPAMS	(303)623-0987
Ed Johnson (Contractor)	IPAMS	

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October 7, 1997- NOTES

9:00AM--hookup with Carla Wilson and Ed Johnson (Contractor) of IPAMS via telecon

Deborah Gibbs Tschudy
-- introductions/opening/housekeeping
-- next workshops -- 10/16/97 Bakersfield, California

-- 10/16/97 Casper, Wyoming
-- 10/21/97 Roswell, New Mexico

Ben Dillon
-- What is format of next workshops?

Deborah Gibbs Tschudy
-- Explain how rule works, give alternatives, ask for input--Federal Register notices available 10/8/97

Deborah Gibbs Tschudy
-- covered day's agenda and 10/8 agenda
-- everyone introduced themselves
-- will make minutes available for public/part of administrative record

Ben Dillon
-- IPAA wants to stress again their concern regarding time constraints/anything presented today is best they could do under circumstances. If MMS wants more information, hopes MMS will allow IPAA to have more time to further develop points. Wants Director/AD to look at IPAA work and consider in decision making.
-- IPAA has lots of experts in audience--wants them to be able to speak where appropriate.

Deborah Gibbs Tschudy
-- That is fine

Carla Wilson (IPAMS)
-- Thinks lease--based comparables should be 1st benchmark
-- (1) geographic area
(2) like quality (gravity within 10%, sulfur $>$.5% is sour, $<$ .5% is sweet; H_2S is separate category for comparables; proposes similar distillation curves (DOE established ± 5%), and any other industry--based characteristics.
(3) rather than like-quantities, use method of transportation because price is function of

method of transportation/crude probably has access to same market
(4)timing of transaction

Deborah Gibbs Tschudy
-- needs clarification of like quantities

Ed Johnson
-- method of transportation has great impact on crude oil value. Doesn't want value of small quantity impacting value of large quantity.

Carla Wilson
-- 2 alternatives: producer election proposed for each
(1) Same date of delivery
(2) equal daily pricing
-- will fax document to us and Ed Johnson will further explain

Deborah Gibbs Tschudy
-- If 2 or more contracts, would you do volume-weighted-average?

Carla Wilson
-- Hadn't discussed, but thinks so

Don Sant
-- Who would track?

Carla Wilson
-- The purchaser

Don Sant
-- Is this like IPAA's proposal last week?

Ben Dillon
-- IPAA had producer-driven proposal then.

Ed Johnson
-- Thinks can move to purchaser-driven system with little effort

Don Sant
-- How document, if producer can't explain value?

Ed Johnson
-- Would be difficult if producer couldn't document

Greg Smith
-- How do you define geographic area?

Carla Wilson
-- Didn't get there yet

Ed Johnson
-- Discussed generalities such as canyon boundaries

Deborah Gibbs Tschudy
-- Is this proposal in terms of defining 1st benchmark from last week's IPAMS proposal?

Carla Wilson
-- Yes

Ed Johnson
-- Daily arithmetic average for month of each of comparable contracts

Carla Wilson
-- Would use weighted average by days each contract in effect

Deborah Gibbs Tschudy
-- Would consider comparable because of same date of delivery?

John Munsch
-- They're identifying transactions by method of transaction. Industry has gone to "equal daily quantity."
-- What is MMS policy on this?

Deborah Gibbs Tschudy
-- Whatever contract says
-- 3 criteria for comparability
  (1) geographic criteria/areas
  (2) like quality
  (3) similar quantity
  If you have comparability, use to value non-arm's-length transactions

Carla Wilson
-- Agrees

Tammy Naron
- -- difficult to define areas--can be defined, but not in 2 hour phone call
- -- because is non-arm's-length transaction and purchasing arm may be buying from others, need to refer to "purchasing arm" of producer
- -- Company wouldn't have access to contractual information, unless had access to 3rd party data base

Ben Dillon
- -- IPAA has its own proposals

Deborah Gibbs Tschudy
- -- For Carla--did you talk about how much of volume needs to be accounted for?

Valdean Severson
- -- What if purchaser deems quality?

Ed Johnson
- -- Concerning comparability, this is the price mechanism and not a qualifying factor.

Valdean Severson
- -- But how different from equal daily pricing?

Ed Johnson
- -- Says is a different concept--deemed gravity is a price mechanism
- -- If producer elects to be paid on day of delivery, value is determined then. If chooses average daily price for month, that's value.

Carla Wilson
- -- Would have to compare to sales made under same election

Ed Johnson
- -- Trying to avoid comparison with contracts with different pricing alternatives. Look at price clause to compare apples/apples.

Valdean Severson
- -- How do you deal with producer-affiliate contracts under such circumstances?

Ed Johnson
- -- Should compare with similar transactions in area

Valdean Severson
- -- If you don't have contracts with equal daily quantities, should you look to other contracts in area/expanded area?

Ed Johnson
-- Yes

Ben Dillon
-- At last meeting we didn't see much support for lease-based indicators
-- will talk to broad categories, not at great level of detail
-- lease benchmark remains part of IPAA package
-- start with tendering program; lease comparables second, then RIK & netback
-- still concerned about winner/loser approach--thinks lease-based approach would solve problem
-- wants to hear MMS's specific concerns as to why benchmarks don't work
-- general system of winner/loser still questioned by IPAA
-- if know MMS concerns, can better move ahead
-- thinks RIK is the answer. Wants to dispel notion that because IPAA talking about alternatives, doesn't want RIK as the valuation method.
-- field/area--throws it back to MMS to look at details surrounding fields/areas. Does MMS believe we can't define field or area?

Greg Smith
-- Have done for major portion

Deborah Gibbs Tschudy
-- Can be done, but looking for suggestions

Dave Darouse
-- Thinks offshore producers have already defined areas--delivery to specific aggregation points.

Ben Dillon
-- regarding like quality: thinks is "doable"--by formation, like gravity, 3160 information. Does MMS think this can be resolved?

Deborah Gibbs Tschudy
-- Yes--payor needs to know they paid correctly as payment occurs.

David Blackmon
-- same pool an adequate comparison technique?

Valdean Severson
-- Pool and Formation different--also, quality can vary monthly

Ed Johnson
-- sulfur will fluctuate slightly month-to month

Ben Dillon
-- hesitancy to get into great detail because of perceived hesitancy by MMS

Deborah Gibbs Tschudy
-- but for Rocky Mountains region and California may need extra detail--may not have index option available

Ben Dillon
-- let's see if there are general criteria, and then adjust as needed for offshore, etc.
-- for quantity: all info is producer driven. Willing to look at volumes in tendering--willing to talk about 10% further, and MMS's concern about risking greater amounts. Wants to know more about MMS 50% proposal
-- Volume-weighted average is something IPAA wants to talk about. Look at "captive markets" and see if they could be treated as an exception.
-- MMS: "how do we know these are arm's length contracts?"--IPAA is willing to certify and/or discuss further.
-- leads back to certainty & simplicity. Does see audit/administrative simplicity in IPAA's proposed procedures.

Tammy Naron
-- thinks items from MMS's audit report for gas would lead to similar benefits for oil

Deborah Gibbs Tschudy
-- How do we avoid looking at contracts and thus minimize audit burden?

Tammy Naron
-- Will MMS be satisfied without looking at contracts?

Deborah Gibbs Tschudy
-- Index pricing is an alternative to address audit burden

Becky McGee
-- Will still have issues requiring review of other facts even if go to index

Ben Dillon
-- MMS wants to trade market value for simplicity
-- IPAA member: why should I do that when I have significant quantities of arm's length purchases at the lease? Why should producer go to theoretical netback?

Mary Stonecipher
-- Small fields vs. large fields give different results

Becky McGee
-- need to carve out "non-matching" or non-comparable situations?

Don Sant
-- What about areas such as California, where is small amount of affiliate purchases at arm's-length vs. non-arm's-length?

Valdean Severson
-- may need certification that significant quantities purchased at arm's-length
-- why have things changed to allow looking at affiliate purchases?

Ed Johnson
-- Because trying to accommodate actual situations

Dave Darouse
-- Doesn't see affiliate purchasers buying at lease very much

Tom White
-- Runs independent marketing firm, but purchases ≈ 50% of volume from 3rd party. Affiliate also has production going into same pipeline

Don Sant
-- Individual sales volumes at small percentages of affiliate production may not qualify as comparables under existing rules

Richard McPike
-- Wants clarification

Don Sant
-- Explained comparability notion under current rules regarding quantity

John Clark
-- Says this is problem of aggregation. If can't find comparable quantities <u>offshore</u>, have no hope <u>onshore.</u>

Ben Dillon
-- Why, if buying significant volumes arm's-length at lease, can't such prices be used? MMS telling them they must go to NYMEX, etc.

Deborah Gibbs Tschudy
-- Maybe could use this as a 1st benchmark in areas such as Rocky Mountains, and California

Ben Dillon
-- Views as discriminatory behavior offshore.

Becky McGee
-- Value of benchmark is that where comparable exists, this is best value indicator. When benchmark not applicable, move to next benchmark. Even if offshore, use comparables.

Greg Smith
-- Would you want potential of MMS later second-guessing on audit?

Becky McGee
-- If rules known, wouldn't be second guessing

Greg Smith
-- Not confident benchmarks could be that certain and straightforward

Randy Bolles
-- Would always have second guessing unless MMS publishes price

David Blackmon
-- Second guessing will occur, even under NYMEX (e.g., gravity adjustments)

Becky McGee
-- Under comparability, concern yourself with aberrations rather than every single transaction.

Randy Bolles
-- Auditors benefit from looking at details

Ben Dillon
-- IPAA membership understands there's audit exposure no matter what. But membership doesn't think NYMEX represents lease value. Not willing to trade off less audit for NYMEX

David Blackmon
-- Does Department anticipate NYMEX will not be money-maker for government?

Don Sant
-- Would be benefit over posted prices. But not designed to start at lease as under current rules.

Ben Dillon
-- Where do we go from here?

Don Sant
-- Under current rules, can't demonstrate significant quantities bought/sold at arm's length

Becky McGee
-- MMS saying there's not enough comparables out there?

Don Sant
-- MMS Management doesn't believe there are enough comparables--that we typically would then move past 1st benchmark we've talked about here

Dave Blackmon
-- Agrees that purchase at arm's length of significant quantities is a minority situation. But, where it occurs, is fair measure of value

Jim McCabe
-- California's position is that this doesn't happen at all

Deborah Gibbs Tschudy
-- Whatever percentage is, do we take average of all arm's-length purchases, or average of only those comparable?

Becky McGee
-- Only those comparable

Ben Dillon
-- Volume-weighted range of prices for comparables should be used

Becky McGee
-- Make sure you use only comparables

Deborah Gibbs Tschudy
-- For Tom White: How many of your arm's-length purchases are comparable to your transactions with affiliates?

Tom White
-- Contracts typically are comparable--at least 75% of arm's-length contracts are comparable to non-arm's-length contracts
-- Come back to the point where we see market value should be established.

Don Sant
-- Want specific criteria to establish comparability between arm's-length/non-arm's-length contracts

Tom White
-- Most predominant value factor remains posting (plus premium)

Deborah Gibbs Tschudy

-- What about Spot?

Tom White

-- The posting + premium value is spot. The Company "we all use" is Koch. Platt's can come into play, maybe including differential. Values above or below can occur; variances for sulfur, gravity, and transportation can occur.

(Break @ 10:40AM)

Ben Dillon

-- There are some folks in audience that would like to contribute but can't be with us all day. I would like to give them an opportunity to speak.

Fred Hagenmeyer

-- My company is active in lease market. We use our own benchmark system . We have found you need to be specific, otherwise, details fall through the cracks. It's still the best representation of market value. We have maintained data for audit. We think you could use MMS data from outright sales and purchases at the lease. The burden would fall on producers to report a little more information than we currently do. Key quality elements could be obtained from gravity tables and sulfur tables which are readily available. There would be some exceptions for metals. You would need to differentiate sweet and sour separately. Within a gravity category, MMS could maintain data for comparables. We are a net purchaser. We purchase four times our production. The marginal price drives the market. We are sensitive to one party driving the market, but it's hind sight to talk about a percent of production. It can vary significantly.

David Darouse

-- What role does price play in the volume offered?

Fred Hagemeyer

The producer doesn't generally drive the price unless really large quantities are involved. The lease market requires a lot more work to purchase the needed volume.

John Munsch

-- It goes both ways if you offer a lower price, you will get less volume.

Deborah Gibbs Tschudy

-- For the 1st Benchmark, we feel the threshold number has to be greater than ten percent for MMS leases. Eighty percent of MMS production comes from the majors. Can API comment on this?

John Clark

-- I Can't speak for majors. I have a lot of people I have to deal with. I have no input to report from the majors.

Deborah Gibbs Tschudy

-- Is there any indication that NYMEX will work for the first benchmark?

John Clark

-- We want a lease base method

David Deal/Richard McPike

-- Much of what IPAA say about benchmarks make sense to us. Our comments on the proposal have been clear.

Deborah Gibbs Tschudy

-- We have been trying to get input on alternatives without much input. Do you support January 24 Rule?

David Deal

-- No. We haven't had time to come up with alternatives.

Greg Smith

-- Do you think the recent settlements can be used in support for a position?

-- NYMEX is in these recent settlements.

David Deal

-- These are non-federal settlements. Some particular approach not going to always apply. We could use Pork bellies if both sides agree.

David Blackmon

-- Part of the arrangement is being ignored. The companies get a marketing allowance in these settlements.

David Deal

-- Ask Mobil and or Chevron

-- The message is clear that you are starting at wrong end. You don't get "home" to the wellhead with it. We are dancing as quickly as we can. We support RIK and tuning the existing regulations. This discussion makes it difficult to deal with alternatives in the abstract. We still have too many questions. Laying out the alternatives in the Federal Register is a good first step. Workshops are a good second Step. We will look at what is proposed. We want something with concrete details.

Mary Stonecipher
-- We are in the same boat as API & COPAS. We have not had a chance to canvass our members. Our members are looking to value oil at the lease by using benchmarks and comparable sales. We need a better definition of arm's-length and non-arm's-length sales. Why not use MMS RIK oil and companies tendering oil to establish royalty value?

Greg Smith
-- Why the change from gas regulations approach?

David Deal
-- There are real differences between the oil industry & the gas industry . We are trying to draw a line that is clearer. That's a fair question, we are not in position to tell you.

Fred Hagemeyer
-- Physical characteristics are different. In oil you have a true and very active lease market. In gas, the hub is where transactions occur. Spot prices are more developed for gas.

David Simpson
-- Gas has historically been delivered by pipelines
-- Basis trading sprung up. Pipeline spots are closer to lease. Cost of gathering gas much more since all gas must be connected to pipeline. Oil can be trucked.

Carol Harvey
-- Time is still at too much of a premium to get good answers from end of last week. I care about issues, but have not had enough time to work on this.

Don Sant
-- You have to take crude to market (i.e., refineries). You need similar volumes for a good comparable benchmark.

David Simpson
-- Our point exactly.

Don Sant
-- We don't have good comparables at the leases. Downstream is where we find comparables work.

Deborah Gibbs Tschudy
-- Let's move to deductions for marketing. For arm's-length and non-arm's-length for affiliate sales. Should there be hard cost reductions?

Ben Dillon
-- MMS will be happy to learn IPAA did our homework assignment. For midstream activity we have compiled a list of costs. We have a handout for everyone to look at.

Debbie
Have you assigned values to these?

David Blackmon
-- Let's be clear on our concerns. The proposed rule establishes price at NYMEX with duty to market. This is a nationwide price. Does this mean all oil has to be sold in Cushing? Can you come back 5 years and tell us our lease price should have been uplifted to Cushing prices. We have genuine concerns about litigation for NYMEX. Then we need to discuss marketing costs Both the Mobil and Chevron settlements account for these costs.

Ben Dillon
-- Federal Regulations state mutual benefit of lessee with no cost deducted for marketing. But you are not willing to share in this cost. What is mutual about that? We have done a Survey on marketing activities (hand out). The range of costs is 7¢ to 15¢ per barrel. This is in its infancy. It's not scientific.

Deborah Gibbs Tschudy
-- Are all of these costs included in your deductible?

Ben Dillon
-- 7¢ - 15¢ may not account for all costs on this sheet.

Don Sant
-- How was the survey done? How do you put costs on risk management?

Ben Dillon
-- These costs are confidential and difficult to break down.

Ben Dillon/Jim McCabe
-- Don't you do these already? How much of this is incremental?

John Munsch
-- We looked at this a few years ago to see if someone could do this service cheaper than we could perform it ourselves. One company offered to perform these services their quoted fees fell in this range.

Ben Dillon

-- Value has not been assigned to each service. These are aggregated costs. We asked accountants to assign values. We have not heard back yet.

David Simpson

-- 7 - 10¢ per barrel are the price quotes we have received for these services, 8¢ is Total's cost. We decided not to hire out this service.

Greg Smith

-- What does midstream mean?

David Simpson

-- Anywhere other than at the well head.

John Munsch

-- MMS wants more value than lease value. Santa Fe engages in this activity away from lease but there are costs associated with this activity.

John Haley

-- These fees don't include market risk of taking possession of the production.

John Munsch

-- There's no way for accountants to come up with these costs.

Deborah Gibbs Tschudy

-- Would producer/refiners add costs to these lists?

Richard McPike

-- We would, if given time, add some costs.

Ben Dillon

-- Our list 7-15¢ is only part of the costs. It could be further refined if we were given more time.

Greg Smith

-- Any feel of number for services for oil sold at the lease?

Deborah Gibbs Tschudy

-- Some of these costs are the same as for sales at the lease.

Becky McGee
-- You will have to pay for contract attorneys to write lease sales.
-- Volumes would be greater downstream so costs would be spread over more barrels.

John Munsch
-- It's far simpler to sell at wellhead.

Greg Smith
-- Is price hedging part of the royalty basis? Is it fair to say these costs are not part of royalty uplift?

David Simpson
-- We don't have title to royalty share . We don't have this asset to hedge.

Bonn Macy
-- Hedging is insurance premium. It costs money.

Becky McGee
-- There seems to be some confusion about risk basis for price.

Dave Hubbard
-- What does royalty bonus development application mean? What are distribution tracing process costs?

Ed Johnson
-- Is time value of money covered? Risks of physical loss? Are these included in the price estimate?

John Munsch
-- These are not identified or segregated out.

Tom White
-- Letters of credit are real costs.

David Blackmon
-- The cost of insurance is easy to quantify.

John Munsch
-- Documentation of quality determination is a cost.

David Darouse
-- These are done for lease sales as well. What about operations in general?

John Munsch
-- Some of these costs will be the same for both.

Greg Smith
-- We appreciate your help on this.

Deborah Gibbs Tschudy
-- To states -- is this helpful for your earlier concerns?

Valdean Severson
-- Yes

David Darouse
-- Yes

Valdean Severson
-- Why is Alberta 5¢ a barrel?

Greg Smith
-- More competition for marketers?

Deborah Gibbs Tschudy
-- What is a picture of costs from IPAA on what is needed to market oil?

Ben Dillon
If MMS has no interest in going down this road, we didn't want to spend time on this.

Deborah Gibbs Tschudy
- The Department is not willing to move on deduction of marketing costs.

Ben Dillon
-- This decision puts our members at "disadvantage."

Don Sant
-- Who is at a disadvantage?

Ben Dillon
-- An affiliate with marketer.

Deborah Gibbs Tschudy
-- No one gets these costs. What's discriminatory?

David Blackmon

-- Refiner goes to index. Non-refiner pays gross proceeds.

Tom White

-- If you don’t pay for our marketing service you don’t get our uplift. Simple as that!

Ben Dillon

-- That is IPAA’s position

Becky McGee

-- Don’t change rules midstream if you want to do this for future leases we will know up front.

Don Sant

-- When was last time you looked at your lease terms.

Becky McGee

-- This is a radical shift in policy.

Bonn Macy

-- Have you ever deducted marketing costs?

Becky McGee

-- If there is not a genuine interest in this, why did you make us go to this effort. What else did you decide to shelve? We could have used our time better on other issues.

Deborah Gibbs Tschudy

-- This is from the states. We approached our management on this issue. MMS stated up front last week that we did not have support for this?

-- We are in same position on other issues. We would like to do this up front too. We would like to talk about other issues, but you don’t have the support of your members.

Becky McGee

-- With this tight time frame, we need to be more open. We have spent time on issues that are not open for negotiation

Randy Bolles

-- We have gone back to out management. There is willingness from Wyoming to look at these costs.

Ben Dillon

-- Why are we not willing to move on marketing costs?

Jim McCabe
-- In exchange agreements, marketing costs are already reflected in differentials.

John Munsch
-- These costs are real.

Jim McCabe
-- These costs won't change based on royalty obligation.

Don Lynch
-- Has MMS taken position on any other issues that we should know about?

Don Sant
-- Precedent has been set for 50 years. The government does not give deductions. Courts have upheld this.

David Simpson
-- There has been a precedent set on costs, but not on value at lease. It strikes us as unfair. This is the kind of thing that gives government a bad name.

Mary Ann O'Malley (worked on Alaska litigation)
-- In the State of Alaska settlement, many costs are recognized (e.g., scheduling and
-- marketing costs). A precedent has been set in this case. It also, recognized cost of holding inventory off the lease. These off lease costs are not all purely marketing.

Ben Dillon
-- Some of these costs could be marketing. We are being put in a bind.

Don Sant
-- Back to the winners and losers argument... if there is a cost accounting for each item we have not reduced anyone's burden.

Dave Darouse
-- A partially integrated company is valuing oil at the lease without deductions.

David Blackmon
-- The solution is to only deduct marketing costs where value is determined away from the lease.

(LUNCH)

Beginning 10/7 PM session (1:50PM)

David Blackmon
-- Noted he was surprised that minutes would be in Federal Register.

Deborah Gibbs Tschudy
-- Said wouldn’t be in Federal Register but part of administrative record.

David Blackmon
-- Can attendees review minutes before putting in record?

Geoff Heath
-- Submit in writing whatever you think might be omitted from record--to do otherwise would unduly bog down the process.

Deborah Gibbs Tschudy
-- Opened discussion on multiple exchanges. Particularly in offshore, multiple exchanges occur.

Ben Dillon
-- Reference IPAA comments PP 13-14--discussion regarding exchanges. Referred matter to Tom White.

Tom White
-- More common to have multiple exchanges rather than one. Because of many proprietary lines, must first enter transaction with that pipe line owner. Then common carrier pipe line goes to, say, three refiners. May enter separate exchange with one of those refiners to mutually benefit both parties.
-- Often maximizing value by getting oil back from proprietary pipe line owner and then entering separate exchange to St James, Cushing, or some other point.
-- LLS barrel this year getting less than Cushing barrel.
-- Although unusual, HLS sometimes valued higher then LLS.

Deborah Gibbs Tschudy
-- Should rule allow value on resale after exchange?

Tome White
-- Yes.

Ben Dillon
-- Allow purchaser option to go to end of exchanges--to arm’s length point--and net back using differentials from exchange agreements.

John Munsch
-- Agrees with Tom White / Ben Dillon on analysis--uses multiple exchanges also.

Jim McCabe
-- California's experience is it's one thing to see multiple exchanges, but quite another to rely on ultimate apparent value. Says exchanges used as vehicle not for trading in value--rather, obfuscating value. May be useful indicator of transportation costs and nothing more.

John Munsch
-- Ultimately he has an outright sale that is appropriate.

Ben Dillon
-- For Jim McCabe--is this your experience for arm's length transactions?

Jim McCabe
--Yes--purpose is to avoid stating ultimate price. California thinks this is to obscure price.

General Response
-- Not familiar with what Jim McCabe discussed.

Ben Dillon
-- Wants to make clear he's talking about ultimate arm's length sale.

Ed Johnson
-- How can marketing company track ultimate disposition of barrels?

Ben Dillon
-- Talking about arm's length exchanges, possibly including exchanges by affiliates.

Ed Johnson
-- Again, how do you track--monitoring nightmare, especially when moving product to Cushing, etc.

John Munsch
-- Needs to know this sales information--does it now --has to do it to keep up with accounting and royalty payments

Wayne Pachall
-- Wanted more detail from John Munsch regarding this accounting.

John Munsch
-- Further described allocation, cost-wise, of bbls. to source.

Ben Dillon
-- Suggests permitting choice between ultimate resale price or benchmark.

Jim Munsch
-- To Tom White: If ultimately get Cushing price why not use?

Tom White
-- It's a matter of his knowledge as to which way to market (Cushing vs. Alternatives)--varies case-by-case.

Jim Munsch
-- What are your (Tom White's)intermediate costs?

Tom White
-- Letter-of credit, etc Also says there are a number of companies who simply sell directly at lease.

Ed Johnson
-- For Tom White, how do you deal with eventuality that you missed market (i.e., NYMEX above what you got)?

Tom White
-- It happens--no guarantees--winners and losers.

Ed Johnson
-- Won't MMS question such losses?

Ben Dillon
-- Simply wants to preserve option to netback from ultimate sale after multiple exchanges.

Don Sant
-- End up with same number of barrels you started with?

Tom White
-- We try to--but marketing end of business deals with trading, and production arm not concerned with that at all.

Valdean Severson
-- Agrees that gross proceeds should drive value.

Randy Bolles
-- Agrees also.

Dave Darouse
-- Agrees also.

Tom White
-- Cash price can differ from NYMEX settle price. Can trade after NYMEX closes. Platt's is verbal canvassing of marketplace. These also quoted at end of day.

Dave Darouse
-- Finds Platt's spot prices tie closely to NYMEX.

Tom White
-- In some cases they diverge--for instance, when Gulf war occurred and after the day's Platt's numbers are developed.

Kyle Harris
-- No disconnect between NYMEX and Platt's. Arbitrage opportunities are available.

Tom White
-- Yes there is, because of cash market. NYMEX has mechanism to reflect value of specific crudes. Can be difference between NYMEX and cash market. Agrees that over time, differences are small.

George Staigle
-- Agrees with resale value after multiple exchanges.

Deborah Gibbs Tschudy
-- API, RMOGA opinion ?

Richard McPike
-- Haven't discussed with membership.

Jm McCabe
-- In disagreement with ultimate resale as value. In <u>pure</u> exchanges, doesn't disagree philosophically, but thinks tracing would be enormous problem.

Ed Johnson
-- Any split of this process intended onshore vs. Offshore?

Ben Dillon
-- No--same in both places.

Deborah Gibbs Tschudy
-- Proposal is for <u>option</u> for producer to trace to ultimate resale after multiple exchanges.

John Munsch
-- Multiple exchanges done to enhance value.

Deborah Gibbs Tschudy
-- Opened discussion on crude oil calls.

John Munsch
-- Whether call says most favored nation or not, goes for market price-- and has been successful in getting that price.

Deborah Gibbs Tschudy
-- For John Munsch: regardless of formal call language, you try to get highest/best price?

John Munsch
-- Yes

Ben Dillon
-- Appreciates MMS changes to rules, but just because call language may appear noncompetitive doesn't mean non-market price involved. Doesn't want such parties to have to go to NYMEX if, say, posted price was best they could get. P10 of DPC/IPAA discusses the call language. Don't know how many calls actually exercised.

John Munsch
-- Small producers don't have the staff to market as aggressively.

Ben Dillon
-- Small Companies would be benchmarked, under proposed rule, under exercised noncompetitive call.

Deborah Gibbs Tschudy
-- Right.
-- Are majors typically putting calls in their contracts?

Fred Hagemeyer
-- Not typically actually in contracts. If included, usually a marketing price call.

Deborah Gibbs Tschudy
-- For everyone, are you seeing more or less calls now?

Mary Stonecipher
-- not sure

Don Lynch
-- Calls may be negotiated in or out of contracts.

John Haley
-- If call can’t be negotiated, may have to take posting .

Deborah Gibbs Tschudy
-- This is exactly the concern we had with calls.

Jerry Hutchinson
-- Real example: sellers--one got $2 bonus, the other didn’t--because of call provision.

Dave Darouse
-- Calls he’s seen are exercisable at former lessee’s discretion. They will go to courthouse to enforce calls.

Ben Dillon
-- The small producer may not be able to do any better regardless of call language. Many people onshore get posted price--for many members this is fair market value.

Dave Darouse/Bonn Macy
-- Posted price not fair market value.

Mike Adams
-- Call is a negotiated part of contract holding value. We want cut of reduced price paid for property because of call.

John Munsch
-- Doesn’t think property price always discounted in call situations.

Ed Johnson
-- Does MMS expect different price under call situation than if original producer sold crude?

Deborah Gibbs Tschudy
-- Since both would go to NYMEX, probably not.

Ben Dillon
-- If there is other consideration, something should be done, but if not, companies should not be forced to NYMEX.

Valdean Severson
-- Producer should have burden of showing it got competitive price. If it can't, go to NYMEX.

Ed Johnson
-- New owner assumed old owner's position--including royalty payment responsibility

Valdean Severson
-- Producer should have to show its efforts to get market price, rather than, say, just accepting posted price from previous owner's contract.

Greg Smith:
-- Question for Valdean, would you accept apparent below-market price if producer demonstrates its efforts?

Valdean Severson
-- Be able to demonstrate efforts through records it maintains.

Deborah Gibbs Tschudy
-- How could they meet burden of proof?

Mike Adams
-- Maybe from records responding to tendering program--actual bids demonstrated.

Ben Dillon
-- Need to talk further with <u>small</u> producers about Valdean's suggestion. Only go to NYMEX when exercise noncompetitive calls

Dave Darouse
-- Gulf producers <u>not</u> "Mom and Pop" operations .

(Break)

Deborah Gibbs Tschudy
-- Let's move to lease to aggregation point and quality and location differential discussion. What have you found out from your marketers--concern about written proposed rule addresses.

Ed Johnson
-- Who would establish these differentials?

Deborah Gibbs Tschudy

-- There are three parts. The market center to Cushing is one. You could either use a price service differential of your actual costs to move oil if you do so. If a company transports oil to a market center it could use its actual costs or the MMS calculated number. Between an aggregation point to lease, you would use actual costs.

Valdean Severson

-- If you have a buy/sell at lease and bought back at Midland, could you use actual differential from the contract?

Deborah Gibbs Tschudy

-- Yes

Audience Member

-- Are differentials for transportation and quality part of this?

Deborah Gibbs Tschudy

-- Yes

John Munsch

-- How do you determine differentials?

Deborah Gibbs Tschudy

-- You could use actual costs including depreciation if a pipeline is owned by the producer.

Randy Bolles

-- Has MMS looked at any non-arm's-length sales and backed off the differential to the aggregation point to see how this uplifted value compares?

Bob Kronebusch

-- We looked at 1995 NYMEX monthly averages. We made some assumptions in Louisiana (1/3 to Empire, 2/3 to St. James) made similar assumptions for New Mexico. We estimated 52 million increase in revenues for MMS using the proposed methodology in 1995.

Deborah Gibbs Tschudy

-- Randy did you have specific concerns about Wyoming numbers?

Bob Kronebusch

-- We did not hone into on differentials for Wyoming, we used published tariffs there.

Dave Deal

-- What does 52 million represent?

Deborah Gibbs Tschudy

-- Estimate on what we would have been paid under the proposed regulations in 1995. Then this would have been the increase in royalty collections.

Ed Johnson

-- Here is your incentive to take oil in kind!

-- What is source of information to determine differentials under the proposal?

Deborah Gibbs Tschudy

-- The 4415 form. Information from existing exchange contracts would be sent to MMS.

John Munsch

-- Everyone would need to report?

Deborah Gibbs Tschudy

-- Yes!

John Munsch

-- And the election by company to use a method for 2 years?

Don Sant

-- To select using the MMS differential or actual costs for a 2 year period.

Mary Ann O'Malley

-- Is MMS concerned about quality adjustments?

Deborah Gibbs Tschudy

-- Lease to aggregation point differentials assume no gravity banks. If they are in contract we could allow these.

David Blackmon

-- What about where you have a component between the lease and aggregation point, and you sell to an affiliate who exchanges the oil to a different place. Then you receive oil at another aggregation point. This will not provide you with the true cost picture.

Deborah Gibbs Tschudy

-- A producer could be hurt where gravity bank doesn't exit, but another producer might gain cost deduction if more than his actual costs.

Don Sant

-- We will provide a rate for public, but you can use your own actual costs.

(NEXT FEW COMMENTS REFER TO DIAGRAM)

John Munsch
-- At 32° a guy gets hurt if there is not a gravity bank.

Deborah Gibbs Tschudy
-- That is Independent of our rule.

Tom White
-- At 22° average, the 20° gravity producer gets hurt

David Blackmon
-- Guy in the Rocky Mountain Region with 20° has to pay on 26°

Don Sant
-- This is not new to this rule and we don't have any ideas to solve this. Do you have any ideas; we hoped you would.

Ed Johnson
-- Positive differentials can solve this.

Don Sant
-- We assumed that the market will take care of this.

Ed Johnson
-- Price at aggregation point has to recognize quality differences.

Don Sant
-- It doesn't have to. What if market doesn't already do this?

Ed Johnson
-- The proposed rule would rely on the market to solve this?

Don Sant
-- If the market doesn't take care of this then what?

John Clark
-- What do I tell auditors in this case?

Ed Johnson
-- Determining the market down stream causes the problem by establishing value downstream.

Don Sant
-- We aren't creating this problem.

Ed Johnson

-- Why would operators do this? It's a fact of life. What is oil worth? It's whatever you can get.

Don Sant

- If market doesn't recognize differences we wouldn't either.

Deborah Gibbs Tschudy

-- What do you do to come up with actual cost from either lease to aggregation point or to move oil to a market center? How do you make a gravity adjustment? What do you do for oil sold under a noncompetitive crude call?

John Clark

Noncompetitive crude oil calls don't have information on costs but will bump the lessee to NYMEX.

Greg Smith

Is this a common situation?

John Clark

More common than you think.

Deborah Gibbs Tschudy

Is the only case for non-competitive calls?

Audience member

What do you do where an independent acquires a property and the seller values on NYMEX? Would you have to value on NYMEX if you sell arm's length?

Deborah Gibbs Tschudy

-- No. If the sale is arm's length you value on gross proceeds.

John Clark

-- If you can't certify you are not using overall balance this would bump you to NYMEX? You may be without cost knowledge to deduct these costs.

-- You could not tell your cost from leases to aggregation points. This is an onshore problem, not offshore. We don't track onshore costs.

John Munsch

-- Any estimate on the burden to industry?

Don Sant
-- We have not redone an estimate after OMB told us to rework the rule.
-- In the last Federal Register we asked for help on this.

John Munsch
-- Would it be helpful if producers who are not required to pay on NYMEX would not be required to report this information?

Deborah Gibbs Tschudy
-- We need the total to calculate this rate for others to use.

Mary Ann O'Malley
-- Many exchanges are not used in determining the needed number. Do we have to submit this information in these exchanges?

Don Sant
-- Aggregation point to market center exchanges for federal oil are the only transactions that will be needed to reported.

Mary Ann O'Malley
-- If we don't have federal oil do we need to report this exchange?

Deborah Gibbs Tschudy
-- If you are moving non-federal oil, no, if you are moving both federal and non-federal we want to know how to allocate different volumes.

-- We would now like to explore the idea of fixed differentials.

Dave Deal
-- Friday--we sent out a survey. NYMEX is the wrong place to start. Differentials are set once a year. We are looking at all these things, we need to think about this? Fixed, tidy differentials vs. self generated MMS calculations. We don't know yet. Does MMS have any ideas?

Ed Johnson
-- Is industry's position that value of transaction on Federal oil sold at Cushing could be based on actual sale price. How does industry feel about this?

Deborah Gibbs Tschudy
-- If this is an arm's-length sale, yes, you could use the gross proceeds sale price.

Jim McCabe

-- Arm's length transportation ought to be available to MMS. If you are disposing of royalty, ask about the third party sales prices. This could form the price basis--we'll say more on October 22.

Mike Adams

-- Why would you give up business by revealing these costs. You make money on transportation differentials.

Ed Johnson

-- The last statement acknowledges that there is a value difference separate of transportation. In some months it's less than the 41¢ tariff. In other months it's more.

Deborah Gibbs Tschudy

-- Dave Darouse has a new proposal for our consideration.

Dave Darouse

-- In Gulf of Mexico, how many aggregation point receive oil from leases into the Burns Terminal? 20? There are many exchanges in a month. A modified proposal would use like quality between aggregation points and major centers to come up with differentials on a cents per barrel basis. It would survey payors every 2 years and ask what differentials for terminals are? Does anyone like this idea?

Deborah Gibbs Tschudy

-- John Munsch told us that terminals do not change their differentials often .

Tom White

-- They could change every month; often it goes against us!

John Munsch

-- It could change often.

Dave Darouse

-- Exchange differentials with quality components are based on gravity banks.

Ed Johnson

-- What rate would you be willing to live with?

Dave Darouse

-- Swings might be a couple of degrees.

Ed Johnson

-- Swings would be wider.

David Darouse
-- You might have to throw out outliers and get rid of commingling points.

Mary Stonecipher
-- We need this to be verifiable. It could be submitted by industry to Lakewood. This would be the least intrusive program.

Ed Johnson
-- Sounds good if the audit burden is done with. Dave will get copies made for us before we leave.

Mary Ann O'Malley
-- It would not be dynamic enough to reflect charges over time. Differentials are sensitive if you increase volume. The method would have to recognize changes more often. Fundamental changes in the market would shift the differential.

Deborah Gibbs Tschudy
-- MMS could amend values after it conducts a survey.

Mary Ann O'Malley
-- I ought to know when things change. I could file more often. I would rather file more often. I would use MMS rate then go back and make adjustments.

John Munsch
-- We would agree to file more often.

Mary Stonecipher
-- Don't like this approach. We don't want to rework data.

Richard McPike
-- API members haven't had a chance to discuss this idea.

John Clark
-- You could do a quarterly survey.

Randy Bolles
-- I don't know how Wyoming feels about this.

Ben Dillon
-- We would have to oppose this; the core valuation issues don't go away.

Valdean Severson
-- MMS will still have to deal with this.

Ben Dillon
-- Yes, the way to deal with this through benchmarks approval!

Deborah Gibbs Tschudy
-- Let's start at 8:30AM and be prepared to discuss alternative proposals

CRUDE OIL VALUATION WORKSHOP--HOUSTON
October 8, 1997 -- Day 2
8:30AM

Deborah Gibbs Tschudy
-- Covered agenda--discussion of alternatives
-- further discussion of Dave Darouse proposal regarding calculating differentials?
-- <u>everyone</u> would use calculated figures

Carla Wilson
-- Would this only be offshore?

David Darouse
-- Yes, and anyone else who wants to use.

John Munsch
-- Like's BP's idea of a true-up (accept calculated figure until actual available)

Mary Stonecipher
-- true-ups cause administrative problems--lots of Federal leases

David Blackmon
-- Also affects royalty adjustments in future, especially for companies with lots of leases.

David Darouse
-- Why not publish averages for those who don't have exchanges (those for whom 4415 originally intended)? Difference would be limiting aggregation points and going to 2 years vs. 1 year

John Munsch
-- Thinks this procedure might make it easier for him

Valdean Severson
-- Limited aggregation points exist in New Mexico

Deborah Gibbs Tschudy

-- If condense aggregation points too much, some producers may not ship there? (But consensus was that the limited aggregation points identified would cover most situations.)

David Darouse

-- trying to limit administrative burden

Deborah Gibbs Tschudy

-- Work in areas other than New Mexico and offshore?

John Munsch

-- May be difficult in Permian Basin--may be many more aggregation points

Jim McCabe

-- Doesn't think of California as having fixed set of aggregation points. Oil can flow in any direction depending on refinery destination.

Mary Stonecipher

-- Is intent of this proposal to eliminate 4415?

Dave Darouse

-- Not sure--May just need subset of data from 4415

John Munsch

-- Sees as just eliminating steps

Valdean Severson

-- Don't need posted price and some other elements from 4415.

Randy Bolles

-- How will this affect integrated companies? (Where exchanges involved between affiliates.)

Dave Darouse

-- Question needs to be resolved

John Clark

-- Anything that reduces envisioned burden is better than what's on table. <u>But</u> data elements requested aren't in Conoco's system. Only has barrels and differentials--not, for example, sulfur content.

Valdean Severson

-- Has MMS thought about how to simplify process?

Deborah Gibbs Tschudy

-- Fixed differentials by zone as noted in Federal Register.

Valdean Severson

-- How do you get the information for fixed rates? How different from 4415 data collection?

Deborah Gibbs Tschudy

-- Rates would be for broader zones--more general--less specificity, more simplicity.

Don Sant

-- Does Dave Darouse's proposal account for transportation to a few limited aggregation points?

Dave Darouse

-- Everyone takes their oil to 10-20 onshore points, ultimately.

Don Sant

-- Companies typically send crude to various aggregation point and trade there--thus the few points in Dave Darouse's suggestion may be too limited and not cover all actual situations.

Ben Dillon

-- Dave Darouse's proposal would eliminate many offshore aggregation points and limit to a few onshore aggregation points.

Don Sant

-- Not convinced that the fewer aggregation points in Dave Darouse's proposal mirrors actual circumstances.

Dave Darouse

-- Have option for companies to come to MMS for exceptions in limited cases where proposal doesn't specifically apply.

Don Sant/Dave Darouse

-- Agree that proposal just "honing down" original procedure from proposed rule.

Randy Bolles

-- All buy-sells he's seen have been at lease, not aggregation point. Lease to market center exchanges seen.

Don Sant

-- At market center have index, then differential applies from there to aggregation point. Can we limit the aggregation points sufficiently to cover situation adequately? Industry doesn't necessarily have differential data from lease to onshore. (John Clark said yesterday such data not tracked.)

Mike Adams

-- Sure companies have such data, just don't track through multiple transactions.

John Clark

-- All such costs would have to be "rebuilt"

Dave Darouse

-- Has to be done no matter what version of differentials used.

Deborah Gibbs Tschudy

-- Proposal might work for offshore and New Mexico (Permian Basin)?

Ben Dillon

-- taking out of context. Would provide some measure of administrative relief.

Valdean Severson

-- Not clear on use of differentials vs actual -- when/where

Deborah Gibbs Tschudy

-- Explained intent of proposed rule. Where actual costs don't exist from lease to market center, would have to use MMS-calculated rate.

Ben Dillon

-- In New Mexico, MMS rate may not be useable in lots of cases--lease to marketing center.

Randy Bolles

-- May not work well in Wyoming either.

Valdean Severson

-- Collect 2 different types of data--get some from marketers also?

Ben Dillon

-- Need 2 sets of data? True up or down later? How long rates good for? These are some of issues needing clarification.

Mike Adams
-- Differentials reflect true market value even if oil doesn't move to the actual market center used as value basis.

Jim McCabe
-- Doesn't want transportation costs taken other than for shortest route available.

David Blackmon
-- Why not give costs to where oil actually moved?

Jim McCabe
-- transportation can affect royalty payment decision.

John Munsch
-- Would move oil to where best economic results obtained.

Jim McCabe
-- <u>Including</u> advantage of royalty payments!

Dave Blackmon
-- Company would move oil to where market exists, and why shouldn't government share in that?

Ben Dillon
-- Where marketing costs concerned, not useful to discuss them when MMS won't allow them.

Mike Adams
-- Can use "synthetic" numbers to mirror actual costs.

Dave Darouse
-- Noted that different rates can apply for some companies on same transportation route/mode under different contracts.

John Clark
-- Because Mobil/Chevron settlements discussed by group. Doesn't do much good to guess what might have been considered by a company in any of their settlements.

Ben Dillon
-- Agrees.

Greg Smith
-- Still concerned with fixed differentials with winners and losers?

Ben Dillon/John Munsch
-- Yes.

Greg Smith
-- Dave Deal proposal has some merit--presumptive differential with potential exceptions.

Ben Dillon
-- Members would ask how many exceptions MMS has approved to date.
-- Is there a way where companies could go to MMS, with certainty, for an exception?

Don Sant
-- Under Dave Darouse's proposal, would companies have adequate backup information to go from aggregation point to lease? Can we do away with lots of aggregation points?

Ben Dillon
-- Philosophically, one aggregation point was too many! Trying to understand Don's point.

Don Sant
-- Minimize number of differentials by omitting aggregation points, but how do you get from lease to aggregation point in all cases?

Ben Dillon
-- What about those who purchase oil?

Deborah Gibbs Tschudy
-- Supplemental rule eliminated provision sending companies to NYMEX if purchase oil. The only ones who don't know transportation from lease to aggregation point are those who exercise noncompetitive calls or who can't certify that there's no overall balance agreement.

Dave Darouse
-- those who have actuals should use them, but otherwise use MMS calculated amounts, including from aggregation points, to market centers. For those who don't move to a market center, peg to market center unless goes to company's refinery--in which case use actual costs.

Don Lynch
-- Excluding tendering proposal?

Deborah Gibbs Tschudy
-- No, Just looking at differential proposal now.

Valdean Severson
-- Anything resolved?

Deborah Gibbs Tschudy
-- Proposal from Dave Darouse
-- Prefer actuals over fixed costs
-- Concern over winners/losers with fixed differentials

Ben Dillon
-- The more we can adhere to actual, the better.

Deborah Gibbs Tschudy
-- Hears more support for actuals.

Mary Stonecipher
-- You're only hearing that from one sector of the world.

Don Sant
-- Still has questions, under 1st benchmark, of how many aggregation points needed in applying NYMEX.

Ben Dillon
-- thinks solution is allowing royalty payments on gross proceeds.

Don Sant
-- IPAA and DPC members have the data to come up with solutions.

Valdean Severson
-- Would have MMS <u>demand</u> the needed rates from companies. All he's heard from companies is they haven't had time to talk about the issues. Would recommend tracing, or index prices less differentials/costs. (If industry groups other than IPAA not willing to discuss rule, they shouldn't be at the table)

Ben Dillon
-- Since marketing costs are off table, may not be useful to go through an academic exercise.

Deborah Gibbs Tschudy
-- If don't get other ideas, MMS may have to go to solutions such as fixed rates by area.

Valdean Severson
-- He would support MMS in this.

Deborah Gibbs Tschudy

-- Now we can start discussing broader areas such as lease-based benchmarks, etc.

Valdean Severson

-- Doesn't think this will do much good--groups represented here know what their positions are.

Carla Wilson

-- Not enough time to assemble membership and come to grips with issues.

Dave Deal

-- Keep hearing majors bring nothing to table, but between February and May commented extensively on proposed rule. But since then MMS has put forth non-specific proposals and majors asked "What else do you have to say"? Thinks it's insulting to say majors not bringing anything to table when proposals by MMS aren't specific and there's not enough time to assemble membership on short basis.

Carol Harvey

-- Helpful if MMS leadership would narrow proposals to a few specific ones for a follow-up meeting and <u>have them participate</u> in such a meeting.

Deborah Gibbs Tschudy

-- MMS took all comments seriously. <u>Do</u> want to continue with workshops to get input for a further notice of proposed rulemaking. MMS used the comments received to date and will use the workshop results to put together the further notice.

(BREAK)

Deborah Gibbs Tschudy

-- Let's start discussion of alternatives. We have identified common themes in the alternatives. There is general agreement on calls. There is general agreement on multiple exchanges (except California). There is general agreement on differentials. (needs more work for California).

-- Outline:
Rocky Mountain Region vs. California vs. Mid Continent and OCS
Refiner/non-refiner
Tendering/RIK
Lease based
Spot vs. NYMEX

-- Best use of our time is probably in the benchmarks. Let's start with tendering and see if we can reach some common ground.

Ben Dillon

-- IPAA is willing to talk about needed volume and the percent necessary to put a producer at risk. We are willing to move to royalty rate level--see this as 1st benchmark.

Greg Smith

-- Do you want a broad criteria of a case by case exception? Which is preferred?

Ben Dillon

-- We have a mixed answer--we don't think MMS/industry will be able to do this workload. We want to be sure that there is no second questing through audit.

Greg Smith

-- Is there a time period for how long this tendering approval will last? 1 year 2, forever?

Mary Stonecipher

-- Forever.

Jim McCabe

-- Tendering program in California is not workable.

Randy Bolles

-- Wyoming could consider tendering as a 1st benchmark. We need a minimum of 3 bids and must receive 10-20 percent minimum. Can't speak for other Rocky Mountain States.

George Staigle

-- Is there a better way to determine the market? By benchmarks?

Valdean Severson

-- We have already gone on record about tendering. New Mexico will review this.

Dave Darouse

-- We have not discussed this with management. I think you need a minimum 20 percent in each pricing zone. OCS zones need to be arranged by pipeline connection (that would be the one zone). Then, adjust to other platforms based on the cost to move to a connection point. Tendering would also be by zone. There is another problem with the OCS lines. FERC is not regulating these lines. We have concern about FERC.

Randy Bolles

-- This method would have to apply refiners only--in Wyoming. Non-refiners want resale value used.

Dave Darouse
-- Lease comparable would have to get thrown out if we use tendering. The use of NYMEX net back is preferred.

John Munsch
-- How often could you change your approach? How do you stagger at Conoco?

John Haley
-- We stagger the start of the contracts for administrative purposes, so they don't all end at the same time.

Randy Bolles
-- How do you handle geographic areas in tendering?

John Haley
-- In one area we use tendering; in other areas we don't tender. It depends on a number of concerns. In some areas, like the Four Corners Area, we don't feel the market is liquid enough to warrant the effort. That brings me to a point I would like to address. We have a concern about the minimum of three bids. It's too restrictive. There are not always three bidders. We would want to be able to bid out anytime, even in the Four Corners Area, to avoid NYMEX. We need to be able to demonstrate to MMS what the market constraints are and why we can't get a better price.

Deborah Gibbs Tschudy
-- We have a concern about the possibility of gaming this program. What percentage is acceptable for a minimum volume to tender to establish royalty value?

John Haley?
-- We are getting a letter from our economist. Currently we offer up to 100 percent, but we can pull all but 10 percent back. Our goal is to get a bid price on 100 percent, but our affiliate can match the price for 90 percent, and only ten percent will be sold to a third party. For trucked leases -- you either buy 10 percent or 100 percent. There is no volume offered in between for these leases.

-- Conoco's program:
There are 4 types of leases:

Offshore &
Onshore pipeline leases } between 10 and 100% for these leases

Truck leases &
Cluster leases } 10 percent or 100 percent for these leases

-- bids have been above posting in every case
-- Conoco is also out buying crude to fill its refinery needs.

Don Sant
-- Conoco is a net buyer of crude oil, so essentially, it's doing this to avoid value disputes with royalty owners. Second, this is a RIK program with Conoco as marketer--wouldn't MMS want to be able to choose its marketer?

Dave Blackmon
-- Does this idea apply to any non-arm's-length transaction or just to a refiner? What's MMS's position?

Ben Dillon
-- If marketing is not discussed, then tendering becomes more important.

Randy Bolles
-- A sale where you back off costs is preferable to a tendering program--including marketing--some of these marketing costs are transportation.

Becky McGee
-- Administratively, tendering for a nonrefiner is preferable to NYMEX. You might get some agreement for a lease-based market based on tendering, rather than index. Lease based value is always preferable.

Greg Smith
-- It may be a good benchmark.

Ben Dillon
-- Philosophically, has some attraction.

John Munsch
-- You have to take this into account when you can't get a number of minimum bids (i.e. only one buyer).

Deborah Gibbs Tschudy
-- OK. Other than California, I sense some agreement on tendering.

John Clark
-- when you put in generic words, problems surface. You can't get one percent that will work for all cases. Our experience has shown us this. What is equity oil at risk? Government will mandate what minimum percent must be sold. This may not always make sense.

Greg Smith
-- Good point. Specifics must be looked at.

Ben Dillon

Is this something that the director will buy off on?

Debbie Gibbs Tschudy

-- Her concern is that program maybe subject to gaming. I think she would want the minimum amount to be above the royalty rate.

-- How do states feel about a government run RIK program to base values on where government doesn't take in kind?

Randy Bolles

-- Wyoming will entertain comparable sales if MMS runs a workable RIK program. If values rise we'll support it. We like the idea of a RIK pilot. We will see what happens before we commit to RIK. The current program doesn't work.

David Darouse

-- Louisiana doesn't want Government in the business of marketing oil.

Jim McCabe

-- Doesn't' think Federal Government will do any better than California has done with its selloffs.

Valdean Severson

-- It's a can of worms. It will lead to litigation where the high price taken by a company is not representative of all value captured by that company for the royalty share.

Deborah Gibbs Tschudy

-- Next proposal <u>Lease Based Benchmarks</u>

Ben Dillon

-- We did this yesterday.

Valdean Severson

-- There is a problem recognizing value at lease for non-arm's-length sales. We don't think it will solve problems we have now. With today's benchmarks, comparable sales lacks an information component. There's no price discovery. There will always questions about what these numbers are.

David Blackmon

-- There is a range of values. It's not one fixed number. Different players can get different value based on expertise, volume quality, and marketing efforts. We don't have access to comparable sales either. First benchmark may be only used by a few but still, this is preferable to use for these payors.

Randy Bolles

-- MMS has this data but timing is the problem. How will the payment be based on real time data?

David Blackmon

-- There is no way for industry to verify this information.

Jim McCabe

-- In California, we don't believe a real market exists at the lease.

Deborah Gibbs Tschudy

-- There is MMS support for a lease base in the Rocky Mountain Region. We think index will work in Gulf and Mid Continent.

Randy Bolles

-- Wyoming doesn't speak for Rocky Mountain States.

George Staigle

-- As for myself, not North Dakota: We have tried to establish market value at lease or value close to the lease. If gross proceeds are higher, use gross proceeds. You have to compare these. Some of this would go away with single market value to use arm's length sales. I don't think benchmarks will get us there. Lease asks us to pay on market value at lease. We are spending too much time on individual players and not on the market value. We can't accommodate everyone.

Becky McGee

-- The objective is the same. We have a different way of getting there. I think market value is a range of values.

David Darouse

-- Comparables don't work in the 88 rule. The engine is broken, changing the spark plugs won't fix it.

Ben Dillon

-- What is concern with range of values.

David Darouse

-- As an auditor, the burden is enormous. For volumes greater than 50% of field, if there are limited contracts, this could work. But, if there are 15 contracts, this is too much to get to market value.

Valdean Severson

-- Small volumes would be used to value large volumes.

Greg Smith
-- How many companies fall into non-arm's-length?

Fred Hagemeyer
-- Many companies could fall into this category. 10-12 are refiners. But many small companies trade oil.

Greg Smith
-- If there are a manageable number of arm's-length companies, could we come up with negotiated approach?

Ben Dillon
-- There are 3 or 4 non refiner purchasers in Wyoming. This is an active lease market. This is definable.

Mary Stonecipher
-- Negotiated method was an earlier proposal.

Greg Smith
-- The thought was to solve Rocky Mountain problem.

Mary Stonecipher
-- How would negotiation work with 20 solutions or consensus by 20?

Greg Smith
-- No preconceived notion.

Ben Dillon
-- Tendering is lease activity that spills over into benchmark. Is there any sort of philosophical approach that satisfies the lease based benchmark?

Don Sant
-- It's attractive. Details will need to be worked out. But, concept is attractive, if you are able to solve volume and quality issues, etc. The 88 rules were designed to be self executing. This has not occurred. What are comparable sales? It's not clear. The data are not available. It hasn't worked.

Fred Hagemeyer
-- Spot price reporting data are suspect. They can be good or not good. If service could report on a lease based market, would this be acceptable?

Don Sant

-- We tried to do this with lease data under the 3rd party confidentiality initiative. API wanted to go slowly, but IPAA trashed this idea.

Ben Dillon

-- To Fred Hagemeyer, this was flavor of the first set of comments by association. We had a tough time; producers didn't support this idea.

David Darouse

-- Could you gather gravity and quality information? A service would have to verify the data.

Fred Hagemeyer

-- Maybe that's something to explore. You could test this by comparison to MMS value.

Deborah Gibbs Tschudy

-- Platt's tracks its trades and verifies them; they throw out bad or suspected trades.

Peter Christnacht

-- Do you think there is a market for this service?

Fred Hagemeyer

-- There could be. There is interest and need for some of this information by many parties now.

(BREAK)

1:00PM Session

Becky McGee

-- Can we talk about format for next meeting?

Deborah Gibbs Tschudy

-- Public meeting with a podium/microphone

-- no court reporter

1. Summary of 2 workshops
2. Summarize Federal Register alternatives
3. Open up for comments
4. Timing 9:00AM to 4:00PM

-- could we get more marketers at meeting?

Ben Dillon

-- role of workshop attendees?

David Hubbard
-- No established role for team

Deborah Gibbs Tschudy
-- "Chime in" as appropriate
-- Casper, Bakersfield, Roswell meetings more of an educational nature for independents.

Deborah Gibbs Tschudy
-- Lease-based benchmarks--heard from State attendees there's little support for this except for need in Rocky mountain area
-- What are price discovery mechanisms in Rocky Mountain area?

John Haley
-- Look to price of incremental barrel. Interested in lowest-priced feed stock we can get. Say, alternative crude from Alberta.

Deborah Gibbs Tschudy
-- What is benchmark--how do you know price you need to beat?

John Haley
-- Marketers/buyers trying to beat their internal assessment of value. (Most barrels don't actually trade until 4-5 day window at end of month--says this is only time when Platt's data truly meaningful)
-- Doesn't know a meaningful "benchmark" other than tendering.

Deborah Gibbs Tschudy
-- What do we do in Rocky Mountain Region where no refining/no arm's length contracts?

John Haley
-- talk with other marketers/Ed Johnson, others more familiar with Rockies

Deborah Gibbs Tschudy
-- We'll try to get more feedback at Casper meeting
-- Feedback on benchmark breakdown: Rocky Mountains vs. California vs. Mid-Continent and OCS?

Mary Stonecipher
-- Need separate benchmarks if people don't reach agreement on negotiated amount?

David Deal
-- API needs more detail before can answer
-- doesn't think ANS works well for California, but something else might.
-- At abstract level, the breakdown is plausible.

Mary Stonecipher
-- Stay as uniform as possible procedurally within each of 3 breakdowns.

Becky McGee
-- Agrees. Wants assurance multiple systems not needed

Deborah Gibbs Tschudy
-- Refiner/non-refiner split--comments?

Becky McGee
-- Doesn't like fashioning rule around way someone's business conducted. Thinks we should address fact situation instead.

Valdean Severson
-- Non-refiner should have gross proceeds--thus should treat differently.

Becky McGee
-- What about refiner that <u>does</u> have gross proceeds?

Valdean Severson
-- If no tie with refinery and gross proceeds received, <u>would</u> look to gross proceeds.

Jim McCabe
-- California has situations where refiner trades oil away

David Deal
-- Categorical decisions such as refiner/non-refiner split are dangerous. Should look to reality of transactions.

Wayne Pachall
-- Affiliate may be re-seller in Rocky Mountains, but not so in Gulf

Deborah Gibbs Tschudy
-- Rule attempted to do "bright line" between refiner and non-refiner. May want to allow for exceptions.

Dave Deal/Ben Dillon
-- Agree with exceptions.

Dave Darouse
-- What about cases where Company refines some and sells some?

Valdean Severson

-- Would go with NYMEX because main intent is refining.

David Darouse

-- It's how you act that should determine value mechanism.

Deborah Gibbs Tschudy

-- Hearing that there's not support for how you're structured, but how you act. (MOST AGREED)

Jim McCabe

-- Would MMS then have to investigate each case for how company is acting?

David Deal

-- Industry doesn't then have simple system.

Greg Smith

-- Define in Regulations what meant by "how you act" so all will know what's meant.

David Darouse

-- problems month-to-month as flip-flop in company marketing occurs--e.g., NYMEX vs. other pricing?

Deborah Gibbs Tschudy

-- that's why MMS put in 2 years option regarding NYMEX

David Blackmon

-- Tracing through affiliate not simple. Volumes difficult to trace, etc. Why restructure rule for tracing production for non-refiner affiliate--why not also allow netback option? Many most likely would make this election rather than trace through affiliate.

Ben Dillon

-- Asked Deborah Gibbs Tschudy to define clear categories where refiners could ask for exceptions.

Becky McGee

-- Is it MMS's intent to make refiner/non-refiner cut unless better/other suggestions received?

Deborah Gibbs Tschudy

-- Yes--bring comments next week and/or in written comments.

Ben Dillon

-- In IPAA example, everywhere in country except one spot the refiner acts as refiner -- example where different procedures should apply. (Might trade some lease barrels rather than refine.)

-- Why does refiner/non-refiner split appeal to MMS?

Deborah Gibbs Tschudy

-- Simplicity/ease of administration

Mike Adams

-- At some point when refiner sells crude, may no longer <u>be</u> a refiner. Should separate provisions kick in then?

John Munsch

-- DPC has affiliated producer/refiner operating independent of each other. Producer selling at “best price,” refiner buying at “best price.”

Jim McCabe

-- Lots of other considerations. Refiner can act to depress prices.

Deborah Gibbs Tschudy

-- Spot vs. NYMEX--comments?

Dave Darouse

-- Let industry choose spot publication, or average of 3 or 4 publications.

John Clark

-- concerned that spot doesn’t represent market value. But prefers spot to NYMEX.

Mike Adams

-- Price services don’t have vested interests--reported by people who don’t care about price level. Lends credence to independent, 3rd-party price reporting.

John Clark

-- MMS just threw out gas rule, but willing to do oil rule with an index price.

Kyle Harris

-- NYMEX <u>is</u> for actual deals for actual barrels.

Greg Smith

-- Close correlation between NYMEX and Platt’s spot

John Haley

-- Agrees that such prices representative of incremental prices at market center, but not at locations away from marketing center. Has to be reasons company buying oil away from marketing center. Ultimately will result in a few companies dominating market.

Deborah Gibbs Tschudy.

-- Even just for royalty share?

John Haley

-- Could drive all ultimate decisions on prices--all who sell to companies or have interests could demand NYMEX. Conoco still uses posting for buying some crude, and he states it's within range of value.

Becky McGee

-- Can't say price isn't market value simply because it's a posting.

Jim McCabe

-- Barren argument to suggest that posting is value if sellers have no alternatives.

John Haley

-- One rule will cause tremendous problems because of isolated areas. For example:
    - -- S. Texas--few barrels traded; captive market
    - -- industry will always be in position of defending its actions against auditors.
    - -- Conoco trades lease barrels in different locations to satisfy refinery needs.

Bonn Macy

-- that's advantage of having simple system

John Haley

-- Affects small producers more than anyone--could be forced to NYMEX inappropriately.

Jim McCabe

-- No opposition to relief for hostage producers

Don Sant

-- If true gross proceeds, the "hostage" can pay on them.

David Darouse

-- (For John Haley) You say lease sales value not necessarily spot price, but isn't it true that sometimes price greater than spot obtained.

John Haley

-- Yes

Ben Dillon

-- Companies concerned that they will pay royalties on value they don't receive at lease.

-- thinks progress has been made on arm's-length side

-- concerned that non-arm's-length situations will be "cherry-picked"

Becky McGee

-- Does MMS have preference for NYMEX vs. Spot?

John Clark

-- Has to be spot--NYMEX doesn't reflect different crude qualities.

Ben Dillon

-- IPAA--netback is last resort, but need price near lease

Deborah Gibbs Tschudy

-- Explained MMS's initial reasons for picking NYMEX, but mathematically, NYMEX and spot nearly same.

John Munsch

-- thinks spot prices on West Coast not good/easily manipulable.

-- workshop closes